

***West Virginia School of
Osteopathic Medicine***

*Financial Statements and
Additional Information for the
Year Ended June 30, 2002, and
Independent Auditors' Reports*

WEST VIRGINIA SCHOOL OF OSTEOPATHIC MEDICINE

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West Virginia School of Osteopathic Medicine

400 North Lee Street
Lewisburg, WV 24901

Management Discussion and Analysis Fiscal Year 2002 Financial Statements

Overview of the Financial Statements and Financial Analysis

West Virginia School of Osteopathic Medicine (“WVSOM”) is proud to present its financial statements for fiscal year 2002. The emphasis of discussions about these statements will be on current year data. There are three financial statements presented: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. This discussion and analysis of WVSOM’s financial statements provides an overview of its financial activities for the year and is required supplemental information.

The Governmental Accounting Standards Board (GASB) issued new directives for presentation of college and university financial statements. The previous reporting format presented financial balances and activities by fund groups. The new format places emphasis on the overall economic resources of WVSOM. This is the first fiscal year for this new format.

Statement of Net Assets

The Statement of Net Assets presents the assets, liabilities, and net assets of WVSOM as of the end of the fiscal year. The Statement of Net Assets is a point of time financial statement. The purpose of the Statement of Net Assets is to present to the readers of the financial statements a fiscal snapshot of West Virginia School of Osteopathic Medicine. The Statement of Net Assets presents end-of-year data concerning Assets (current and noncurrent), Liabilities (current and noncurrent), and Net Assets (Assets minus Liabilities). The difference between current and noncurrent assets and liabilities will be discussed in the footnotes to the financial statements.

From the data presented, readers of the Statement of Net Assets are able to determine the assets available to continue the operations of WVSOM. They are also able to determine how much is owed to vendors and lending institutions.

Finally, the Statement of Net Assets provides a picture of the net assets and their availability for expenditure by WVSOM.

Net assets are divided into three major categories. The first category, invested in capital assets, provides equity in the property, plant and equipment owned by WVSOM, with title held by the West Virginia Higher Education Policy Commission (“HEPC”). The next asset category is restricted net assets, which is divided into two categories, nonexpendable (permanently restricted) and expendable. Expendable restricted net assets are available for expenditure but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets. Within expendable net assets are balances that have been restricted by the West Virginia Legislature (“Legislature”). These restricted activities are fundamental to the normal ongoing operations of WVSOM and are subject to change by future actions of the Legislature. The final category is unrestricted net assets, which are available for expenditure for any lawful purpose of WVSOM.

Net Assets
(In thousands of dollars)

	June 30, 2002
Assets:	
Current assets	\$ 9,828
Other non-current assets	3,576
Capital assets, net	<u>15,565</u>
Total Assets	<u>\$ 28,969</u>
Liabilities	
Current Liabilities	\$ 2,297
Non-current Liabilities	<u>2,924</u>
Total Liabilities	<u>5,221</u>
Net Assets	
Invested in capital assets	15,565
Restricted – expendable	3,188
Restricted – nonexpendable	46
Balances restricted by State Code	3,796
Unrestricted	<u>1,153</u>
Total Net Assets	<u>23,748</u>
Total Liabilities and Net Assets	<u>\$ 28,969</u>

GASB 35 does not require inclusion of prior year’s financial statements during the implementation year. Comparative information will be provided in the future.

Total net assets of WVSOM increased by \$2.4 million. The changes described below represent the majority of this increase:

- Almost half of this increase was due to an increase of approximately \$1 million in investment in plant, net of depreciation. A pediatrics wing, consisting of 8 additional examination rooms, was added to the Robert C. Byrd Clinic at a cost of \$350,000 which was funded by a Federal grant of \$250,000, and State and private grants of \$100,000. Approximately \$508,000 was expended to complete the renovation of our auditorium into two multi-tiered classrooms, a project that had a total cost of \$1.2 million. Construction of a Student Activities Center began and costs of \$268,000 were incurred out of a total project cost of \$1.2 million. This project will be completed in FY 2003. Storm water runoff caused frequent flooding in the Main building and this problem was corrected at a cost of approximately \$253,000. A project to upgrade the wiring in the Quad and to bring the fire alarm system in the Main building and Quad up to current standards began this year and \$14,000 was expended out of a total project cost of \$100,000 scheduled to be completed in FY 2003.
- Cash and cash equivalents increased by approximately \$1.1 million primarily as a result of two items. First, a shift in investment strategies by the HEPC as recommended by the West Virginia Association of Higher Education Fiscal Officers Investment Committee. Second, a planned budgetary strategy to increase our total assets. A 3.5% operational expenditure reduction was imposed on non-academic units and accumulations from vacant positions were saved. These actions provided an additional \$330,000. This strategy was put in place in anticipation of future State imposed budget reductions.

Statement of Revenues, Expenses and Changes in Net Assets

Changes in total net assets, as presented on the Statement of Net Assets, are based on the activities presented in the Statement of Revenues, Expenses, and Changes in Net Assets (“SRECNA”). The purpose of the SRECNA is to present the revenues received, both operating and nonoperating, and the expenses paid, operating and nonoperating, and any other revenues, expenses, gains and losses received or spent by WVSOM.

Generally speaking, operating revenues are received for providing goods and services to the various customers and constituencies of WVSOM. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the WVSOM mission. Revenues received for which goods and services are not provided are reported as nonoperating revenues. For example, State appropriations are nonoperating revenues because they are provided by the Legislature to WVSOM without the Legislature directly receiving commensurate goods and services for those revenues.

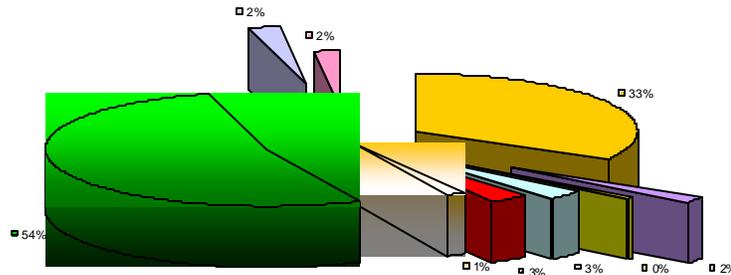
**Revenues, Expenses and Changes in Net Assets
(In thousands of dollars)**

	FY 2002
Operating revenues	\$ 7,004
Operating expenses	<u>13,834</u>
Operating loss	(6,830)
 Nonoperating revenues and expenses	 <u>8,949</u>
 Income before other revenues, expenses, gains or losses	 2,119
 Other revenues, expenses, gains or losses	 <u>299</u>
 Increase in net assets	 2,418
Net assets, beginning of year (as restated)	<u>21,330</u>
Net assets, end of year	<u><u>\$ 23,748</u></u>

GASB 35 does not require inclusion of prior year's financial statements during the implementation year. Comparative information will be provided in the future.

A review of the individual revenue and expense categories that contributed to the overall increase in net assets reveals the following:

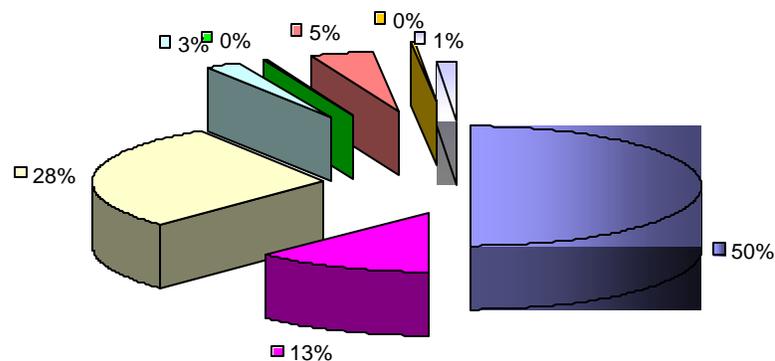
**FY2002 Total Revenues
Operating, Nonoperating, and Capital**



■ Student tuition and fees	■ Contracts and grants
■ Interest on loans receivables	■ Auxiliary enterprise revenue
■ Fees received from the Commission	■ Miscellaneous - net
■ State appropriations	■ Investment income
■ Capital grants and gifts	

- Student tuition and fees (net of scholarship allowance) made up 77% of WVSOM's operating revenues and, as the pie chart shows, 33% of total revenues. Tuition and fee revenues increased over the previous year because both resident and non-resident tuition and fees were increased by 4.0%. We also entered the third year of increasing our entering class size by 10 additional students, 5 resident and 5 non-resident students.
- Other operating revenues such as noncapital grants and contracts, revenues from auxiliary enterprises, fees received from the HEPC, and other operating revenues comprised 23% of WVSOM's operating revenues and, as the pie chart shows, 9% of total revenues.
- Nonoperating revenues from the State consisted mainly of appropriated Lottery Special Revenue funds and a very small amount of appropriated State funds. These State appropriations accounted for 54% of total operating and nonoperating revenues in FY 2002. These funds are used to support the operations of WVSOM.
- Investment income made up 2% of total operating and nonoperating revenues in FY 2002. WVSOM participates in the investment pool managed by the State.
- Capital grants and gifts, under other revenues, expenses, gains or losses, made up the balance of 2% of total revenues. This revenue was from a Federal grant and two private grants received to fund the Robert C. Byrd Clinic's pediatrics wing.

FY 2002 Operating Expenses



■ Salaries and wages	■ Benefits
■ Supplies and other services	■ Utilities
■ Student financial aid	■ Depreciation
■ Loan cancellations and write-off	■ Fees assessed by the Commission for operations

- The salaries and wages, and employee benefits categories made up approximately 63% of the operating expenses of WVSOM. A pool of money equal to 4.5% of the base salaries of all filled faculty, classified, and non-classified positions was made available to distribute to each group of employees. Faculty increases were distributed in accordance with the WVSOM faculty merit policy. With rounding and promotion in rank increases included, the faculty pool of money equaled 5.25%. All classified employees who were not at the equity step were brought to the equity step on the new Mercer Schedule and all other classified staff advanced 12% on the new schedule. With rounding, the classified staff pool of money equaled 4.54%. With rounding, the pool of money used to increase the non-classified staff equaled 4.52%. Benefit costs also increased because of increased employer matching for Public Employees Insurance Agency premiums as well as other matching costs for social security, worker's compensation, etc., associated with raises granted.

Statement of Cash Flows

The Statement of Cash Flows presents detailed information about the cash activities of WVSOM during the year. The statement is divided into five parts. The first section deals with operating cash flows and shows the net cash used in the operating activities of WVSOM. The second section reflects cash flows from noncapital financing activities. This section reflects the cash received and spent for nonoperating, noninvesting, and noncapital financing purposes. The third section deals with cash flows from capital and related financing activities. This section deals with the cash used for the acquisition and construction of capital assets and related items, and related funding received. The fourth section reflects the cash flows from investing activities and shows interest received from investing activities. The fifth section reconciles the net cash used in operating activities to the operating loss reflected in the SRECNA. Overall, cash and cash equivalents increased approximately \$1.1 million for the fiscal year. GASB 35 does not require restatement of prior year cash flows in the implementation year. This is a completely new statement for FY 2002 and there is no prior year data available for comparative purposes.

Cash Flows (In thousands of dollars)

	FY 2002
Cash provided by (used in):	
Operating activities	(\$ 6,373)
Non capital financing activities	8,538
Capital and related financing activities	(1,409)
Investing activities	<u>376</u>
Increase in cash and cash equivalents	1,132
Cash and cash equivalents, beginning of year	<u>7,350</u>
Cash and cash equivalents, end of year	<u><u>\$ 8,482</u></u>

Capital Asset and Debt Administration

WVSOM had several new renovation and new construction projects completed or started during FY 2002 that were added to capital assets. These projects were funded from a variety of sources including a Federal and private grants, and use of WVSOM funds. No capital debt was incurred.



- A pediatrics wing to the Robert C. Byrd Clinic was completed in FY 2002. This project was funded through a Federal grant from the United States Department of Housing and Urban Development, from private grants from both the Robert C. Byrd Clinic, Inc. and the WVSOM Foundation, Inc., and from WVSOM funds.
- Renovation of the old auditorium and two classrooms into two large, state-of-the-art, 80 seat multi-tiered classrooms with Internet connections at each seat was completed. This project was funded using WVSOM funds. No debt was incurred.
- Several land improvements were completed or started in FY 2002. Our campus storm drainage system was upgraded and eliminated the frequent flooding that occurred in the Main Building and Quad. The building that housed our swimming pool was demolished after it was discovered that the pool was leaking a significant amount of water and needed a great deal of work. The tuition and registration fee revenues deposited in the Capital Building/Land Improvement account are dedicated for these types of projects.
- An upgrade to electric service was started on the second and fourth floors of the Quad to eliminate power surges and spiking. The fire alarm system is being upgraded and is scheduled for completion in FY 2003. The tuition and registration fee revenues deposited in the Capital Building/Land Improvement account are dedicated for these types of projects.
- Construction of a new Student Activities Center began in FY 2002 with completion scheduled in FY 2003. This project is being funded using WVSOM funds.
- Another expansion of the Robert C. Byrd Clinic is scheduled to begin in FY 2003. This expansion will add a 16,435 sq. ft. geriatrics wing to the Clinic at a cost of approximately \$4 million. Funding provided by a Federal grant issued from DHHS/Health Resources and Services Administration with a small amount of non-federal funds provided by WVSOM.
- In FY 2003, WVSOM is submitting a request to the HEPC for a new Center for Technology and Rural Medicine that may be funded through the sale of bonds guaranteed with State Lottery proceeds.
- At this time, WVSOM has no capital debt.



Economic Outlook

During the 2000 West Virginia Legislative Session, the governance of higher education in the State was changed. During FY 2001, the governance was vested with the West Virginia Higher Education Interim Governing Board (Interim Governing Board) and, to some extent, the HEPC through June 30, 2001. The HEPC is responsible for developing and overseeing the implementation of a higher education public policy agenda. Effective July 1, 2001 the Interim Governing Board was replaced with a Board of Governors on each campus. Although the impact of these changes is still unfolding, there is a potential impact to WVSOM finances while details of the System wide debt redistribution are considered.

In addition, with less than promising economic forecasts for the State as well as looming deficits in Medicaid and the Public Employees Insurance Agency, no growth or slow growth in Lottery revenues, etc., and with approximately 54% of operations funded by nonoperating State appropriations, WVSOM may be vulnerable to spending freezes and/or a reduction in State appropriations if there is a significant downturn in the State's economy. All State agencies have been asked to submit State appropriation budget requests for FY 2004 at 90% of the FY 2003 level and WVSOM has prepared a strategic plan to offset this anticipated 10% decrease in State funding. The plan has been partially implemented in FY 2003 to prepare for the potential 10% reduction in FY 2004 from nonoperating State appropriations. In FY 2003, both resident and non-resident tuition and fees are increasing by 4.5%, while in FY 2004, we are projecting an additional 7.5% increase for both resident and non-resident students in anticipation of a 10% reduction in State appropriations. Fiscal year 2003 will also culminate our approved strategic plan of adding 10 students to the entering class that increases the minimum entering class size to 75 students.

Although the economic forecasts for the State of West Virginia may be tenuous, WVSOM is well positioned to attract and maintain professional medical students. Increases in non-resident students and class sizes, improved physical plant, and favorable comparison of academic programs at the national level with peer schools indicate that WVSOM should be able to remain competitive for recruitment of new students.

INDEPENDENT AUDITORS' REPORT

To the West Virginia School of
Osteopathic Medicine Governing Board

We have audited the accompanying financial statements of West Virginia School of Osteopathic Medicine ("WVSOM") as of June 30, 2002, and for the year then ended, listed in the foregoing Table of Contents. These financial statements are the responsibility of the management of WVSOM. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of WVSOM at June 30, 2002, and the changes in net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the financial statements, WVSOM changed its financial statement presentation to adopt the provisions of the Governmental Accounting Standards Board ("GASB") Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, as amended by GASB Statements No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus*, and No. 38, *Certain Financial Statement Note Disclosures*, as of July 1, 2001.

The Management's Discussion and Analysis on pages 1 to 8 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the WVSOM's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 11, 2002, on our consideration of WVSOM's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

October 11, 2002

WEST VIRGINIA SCHOOL OF OSTEOPATHIC MEDICINE

STATEMENT OF NET ASSETS

JUNE 30, 2002

ASSETS:

Current Assets:

Cash and cash equivalents	\$ 8,482,998
Appropriations due from Primary Government	62,509
Accounts receivable	436,575
Loans to students, current portion	669,005
Prepaid expenses	93,791
Inventories	<u>82,908</u>

Total current assets 9,827,786

Noncurrent Assets:

Cash and cash equivalents	46,000
Loans to students, net of allowance of \$209,614	3,530,002
Capital assets, net	<u>15,565,076</u>

Total noncurrent assets 19,141,078

TOTAL ASSETS

\$ 28,968,864

(Continued)

WEST VIRGINIA SCHOOL OF OSTEOPATHIC MEDICINE

STATEMENT OF NET ASSETS

JUNE 30, 2002

LIABILITIES:

Current Liabilities:

Accounts payable	\$ 384,319
Accrued liabilities	110,613
Compensated absences, current portion	438,141
Deferred revenue	<u>1,363,833</u>

Total current liabilities 2,296,906

Noncurrent Liabilities:

Advances from federal sponsors	2,016,833
Compensated absences	<u>907,601</u>

Total noncurrent liabilities 2,924,434

TOTAL LIABILITIES 5,221,340

NET ASSETS:

Invested in capital assets 15,565,076

Restricted for:

Expendable:

Specific purposes by State Code	3,796,075
Scholarships and research	58,860
Loans	3,083,216
Capital projects	<u>45,515</u>

6,983,666

Nonexpendable 46,000

Unrestricted 1,152,782

Total net assets 23,747,524

TOTAL LIABILITIES AND NET ASSETS \$ 28,968,864

See notes to financial statements.

(Concluded)

WEST VIRGINIA SCHOOL OF OSTEOPATHIC MEDICINE

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEAR ENDED JUNE 30, 2002

OPERATING REVENUES:

Student tuition and fees (net of scholarship allowance of \$301,072)	\$ 5,424,044
Contracts and grants:	
Federal	75,761
State	130,804
Private	108,103
Interest on loans receivable	79,458
Auxiliary enterprise revenue	471,364
Fees received from the Commission	492,393
Miscellaneous - net	<u>221,747</u>
 Total operating revenues	 <u>7,003,674</u>

OPERATING EXPENSES:

Salaries and wages	6,924,835
Benefits	1,729,928
Supplies and other services	3,908,770
Utilities	376,107
Student financial aid - scholarships and fellowships	6,000
Depreciation	629,993
Loan cancellations and write-offs	48,346
Fees assessed by the Commission for operations	<u>210,113</u>
 Total operating expenses	 <u>13,834,092</u>

OPERATING LOSS

(6,830,418)

(Continued)

WEST VIRGINIA SCHOOL OF OSTEOPATHIC MEDICINE

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEAR ENDED JUNE 30, 2002

NONOPERATING REVENUES:

State appropriations	\$ 8,583,511
Investment income	<u>364,944</u>
Net nonoperating revenues	<u>8,948,455</u>
INCOME BEFORE OTHER REVENUES, EXPENSES, GAINS OR LOSSES:	2,118,037
Capital grants and gifts	<u>299,450</u>
INCREASE IN NET ASSETS	2,417,487
NET ASSETS, BEGINNING OF YEAR (AS RESTATED)	<u>21,330,037</u>
NET ASSETS, END OF YEAR	<u><u>\$ 23,747,524</u></u>
See notes to financial statements.	(Concluded)

WEST VIRGINIA SCHOOL OF OSTEOPATHIC MEDICINE

COMBINED STATEMENT OF CASH FLOWS YEAR ENDED JUNE 30, 2002

CASH FLOWS FROM OPERATING ACTIVITIES:	
Student tuition and fees	\$ 5,166,860
Contracts and grants	310,579
Payments to and on behalf of employees	(8,439,378)
Payments to suppliers	(4,038,108)
Payments to utilities	(365,897)
Payments for scholarships and fellowships	(6,000)
Loans issued to students	(676,350)
Collection of loans to students	608,246
Auxiliary enterprise charges	472,462
Fees from Commission	272,686
Other receipts - net	<u>321,583</u>
Net cash used in operating activities	<u>(6,373,317)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:	
State appropriations	<u>8,538,706</u>
Net cash provided by noncapital financing activities	<u>8,538,706</u>
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:	
Capital grants and gifts received	299,450
Purchased of capital assets	<u>(1,708,803)</u>
Net cash used in capital financing activities	<u>(1,409,353)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest on investments	<u>376,345</u>
Cash provided by investing activities	<u>376,345</u>
INCREASE IN CASH AND CASH EQUIVALENTS	1,132,381
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>7,350,617</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 8,482,998</u>

(Continued)

WEST VIRGINIA SCHOOL OF OSTEOPATHIC MEDICINE

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2002

RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES:

Operating loss	\$ (6,830,418)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation expense	629,993
Changes in assets and liabilities:	
Accounts receivable	(177,855)
Loans to students, net	(10,682)
Prepaid expenses	(7,035)
Inventories	(24,512)
Accounts payable	(29,808)
Accrued liabilities	22,578
Compensated absences	113,686
Deferred revenue	(88,031)
Advances from federal sponsors	<u>28,767</u>
Net cash used in operating activities	<u>\$ (6,373,317)</u>

See notes to financial statements.

(Concluded)

WEST VIRGINIA SCHOOL OF OSTEOPATHIC MEDICINE

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2002

1. ORGANIZATION

The West Virginia School of Osteopathic Medicine (“WVSOM”) is governed by the West Virginia School of Osteopathic Medicine Board of Governors (the “Board”). The Board was established by Senate Bill 653 (“S.B. 653”). S.B. 653 was enacted by the West Virginia Legislature on March 19, 2000 and restructured public higher education in West Virginia. S.B. 653 abolished the Board of Trustees of the University System of West Virginia effective June 30, 2000, and replaced it with a transition year board, the West Virginia Higher Education Interim Governing Board (the “Interim Governing Board”). The Interim Governing Board was granted all powers, duties, and authorities of the Board of Trustees and was transferred each valid agreement and obligation previously transferred to or vested in the Board of Trustees.

Effective July 1, 2001, certain powers were transferred to the newly created Governing Board of each of the institutions of higher education. These powers and duties include, but are not limited to, the power to determine, control, supervise and manage the financial, business and educational policies and affairs of the institution(s) under its jurisdiction, the duty to develop a master plan for the institution, the power to prescribe the specific functions and institution’s budget request, the duty to review at least every five years all academic programs offered at the institution, and the power to fix tuition and other fees for the different classes or categories of students enrolled at its institution.

S.B. 653 also created the West Virginia Higher Education Policy Commission (the “Commission”), which is responsible for developing, gaining consensus around and overseeing the implementation and development of a higher education public policy agenda.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of WVSOM have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (“GASB”), including Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, and Statement No. 35, *Basic Financial Statements and Management’s Discussion and Analysis of Public Colleges and Universities* (an Amendment of GASB Statement No. 34). The financial statement presentation required by GASB Statements No. 34 and No. 35 provides a comprehensive, entity-wide perspective of WVSOM’s assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows, and replaces the fund-group perspective previously required.

WVSOM follows all GASB pronouncements as well as Financial Accounting Standards Board (“FASB”) Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989, and has elected not to apply the FASB Statements and Interpretations issued after November 30, 1989, to its financial statements.

Reporting Entity—WVSOM is an operating unit of the West Virginia Higher Education Fund and represents separate funds of the State that are not included in the State’s general fund. WVSOM is a separate entity which, along with all State institutions of higher education, the Commission and the West Virginia Network for Educational Telecomputing (“WVNET”), form the Higher Education Fund of the State. The Higher Education Fund is considered a component unit of the State, and its financial statements are discretely presented in the State’s comprehensive annual financial report.

The accompanying financial statements present all funds under the authority of WVSOM. The basic criteria for inclusion in the accompanying financial statements is the exercise of oversight responsibility derived from WVSOM's ability to significantly influence operations and accountability for fiscal matters of related entities. A related foundation, clinic and consortium are not part of the WVSOM reporting entity and are not included in the accompanying financial statements as WVSOM has no ability to designate management, cannot significantly influence operations of these entities and is not accountable for the fiscal matters of these entities.

Financial Statement Presentation—During fiscal 2002, WVSOM adopted GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, as amended by GASB Statements No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus*, and No. 38, *Certain Financial Statement Note Disclosures*. These statements established standards for external financial reporting for public colleges and universities and require that financial statements be presented on such basis to focus on WVSOM as a whole. Previously, financial statements focused on the accountability of individual fund groups rather than on WVSOM as a whole. GASB Statements No. 34 and 35 report equity as “net assets” rather than “fund balance”. Net assets are classified into four categories according to external donor restrictions or availability of assets for satisfaction of the WVSOM obligations. WVSOM's net assets are classified as follows:

- *Invested in capital assets*—This represents WVSOM's total investment in capital assets.
- *Restricted net assets, expendable*—This includes resources for which WVSOM is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

The West Virginia Legislature, as a regulatory body outside the reporting entity, has restricted the use of certain funds by “Article 10, Fees and Other Money Collected at State Institutions of Higher Education” of the West Virginia Code. These restrictions are primarily for the following: off campus instruction; public interest research group; libraries, library supplies, and improvement in student services; faculty improvement; health education student loan fund; health sciences education; student activities; auxiliary operations; bookstore operations; and special programs. These activities are fundamental to the normal ongoing operations of WVSOM. These restrictions are subject to change by future actions of the West Virginia Legislature.

- *Restricted net assets, nonexpendable* - This includes endowment and similar type funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to principal.
- *Unrestricted net assets* - Unrestricted net assets represent resources derived from student tuition and fees, State appropriations, and sales and services of educational activities. These resources are used for transactions relating to the educational and general operations of WVSOM, and may be used at the discretion of the Board of Governors to meet current expenses for any purpose.

The provisions of GASB Statement No. 35 have been applied to the year presented. Following is a reconciliation of total June 30, 2001 fund balances, as previously reported, to the restated net asset balances for the same date:

	June 30, 2001
Fund balances, as previously reported	\$ 28,962,851
Accumulated depreciation	(5,644,748)
Reclassification of federal loan programs (Perkins and HPSL)	<u>(1,988,066)</u>
Fund balances, restated as net assets	<u>\$ 21,330,037</u>

Basis of Accounting—For financial reporting purposes, WVSOM is considered a special-purpose government engaged only in business-type activities. Accordingly, WVSOM’s financial statements have been prepared on the accrual basis of accounting with a flow of economic resources measurement focus. Revenues are reported when earned and expenditures when materials or services are received. All intercompany accounts and transactions have been eliminated.

Cash and Cash Equivalents—For purposes of the statement of net assets, WVSOM considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Cash and cash equivalents balances on deposit with the State of West Virginia Treasurer’s Office (the “State Treasurer”) are pooled by the State Treasurer with other available funds of the State for investment purposes by the West Virginia Investment Management Board (the “IMB”). These funds are transferred to the IMB and the IMB is directed by the State Treasurer to invest the funds in specific external investment pools. Balances in the investment pools are recorded at fair value, which is determined by a third-party pricing service based on asset portfolio pricing models and other sources, in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments for External Investment Pools*. The IMB was established by the State Legislature and is subject to oversight by the State Legislature. Fair value and investment income are allocated to participants in the pools based upon the funds that have been invested. The amounts on deposit with the State Treasurer are available for immediate withdrawal and, accordingly, are presented as cash and cash equivalents in the accompanying financial statements.

Allowance for Doubtful Accounts—It is WVSOM’s policy to provide for future losses on uncollectible accounts, contracts, grants and loans receivable based on an evaluation of the underlying account, contract, grant and loan balances, the historical collectibility experienced by WVSOM on such balances and such other factors which, in WVSOM’s judgment, require consideration in estimating doubtful accounts.

Inventories—Inventories are stated at the lower-of-cost or market, cost being determined on the first-in, first-out method.

Noncurrent Cash and Cash Equivalents—Cash, that is (1) externally restricted to make debt service payments, long-term loans to students or to maintain sinking or reserve funds, (2) to purchase capital or other noncurrent assets, and (3) permanently restricted, is classified as a noncurrent asset in the statement of net assets.

Capital Assets—Capital assets include property, plant and equipment, and books and materials that are part of a catalogued library. Capital assets are stated at cost at the date of acquisition or construction, or fair market value at the date of donation in the case of gifts. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, 50 years for buildings and building improvements, 15 years for land improvements, 7 years for library books, and 5 to 12 years for furniture and equipment.

Deferred Revenue—Revenues for programs or activities to be conducted primarily in the next fiscal year are classified as deferred revenue, including items such as tuition and fees. Financial aid and other deposits are separately classified as deposits.

Compensated Absences—WVSOM accounts for compensated absences in accordance with the provisions of GASB Statement No. 16, *Accounting for Compensated Absences*. This statement requires entities to accrue for employees' rights to receive compensation for vacation leave, or payments in lieu of accrued vacation or sick leave, as such benefits are earned and payment becomes probable.

WVSOM's full-time employees earn up to two vacation leave days for each month of service and are entitled to compensation for accumulated, unpaid vacation leave upon termination. Full-time employees also earn 1-1/2 sick leave days for each month of service and are entitled to extend their health or life insurance coverage upon retirement in lieu of accumulated, unpaid sick leave. Generally, two days of accrued sick leave extends health insurance for one month of single coverage and three days extend health insurance for one month of family coverage. For employees hired after 1988, the employee shares in the cost of the extended benefit coverage to the extent of 50% of the premium required for the extended coverage. Employees hired July 1, 2001 or later will no longer receive sick leave credit toward insurance premiums when they retire.

Certain faculty employees (generally those with less than a 12-month contract) earn a similar extended health or life insurance coverage retirement benefit based on years of service. Generally 3-1/3 years of teaching service extends health insurance for one year of single coverage and five years extends health insurance for one year of family coverage.

The estimate of the liability for the extended health or life insurance benefit has been calculated using the vesting method in accordance with the provisions of GASB Statement No. 16. Under that method, WVSOM has identified the accrued sick leave benefit earned to date by each employee, determined the cost of that benefit by reference to the benefit provisions and the current cost experienced by WVSOM for such coverage, and estimated the probability of the payment of that benefit to employees upon retirement.

The estimated expense and expense incurred for vacation leave, sick leave or extended health or life insurance benefits are recorded as a component of benefits expense on the statement of revenues, expenses and changes in net assets.

Risk Management—The State's Board of Risk and Insurance Management ("BRIM") provides general, property and casualty, and medical malpractice liability coverage to WVSOM and its employees. Such coverage may be provided to WVSOM by BRIM through self-insurance programs maintained by BRIM or policies underwritten by BRIM that may involve experience-related premiums or adjustments to BRIM.

BRIM engages an independent actuary to assist in the determination of its premiums so as to minimize the likelihood of premium adjustments to WVSOM or other participants in BRIM's insurance programs. As a result, management does not expect significant differences between the premiums WVSOM is currently charged by BRIM and the ultimate cost of that insurance based on WVSOM's actual loss experience. In the event such differences arise between estimated premiums currently charged by BRIM to WVSOM and WVSOM's ultimate actual loss experience, the difference will be recorded as the change in estimate becomes known.

Classification of Revenues—WVSOM has classified its revenues as either operating or non-operating revenues according to the following criteria:

- **Operating revenues**—Operating revenues include activities that have the characteristics of exchange transactions, such as (1) student tuition and fees (excluding portion for capital improvements), net of scholarship discounts and allowances, (2) sales and services of auxiliary enterprises, net of scholarship discounts and allowances, (3) most federal, state, local, and nongovernmental grants and contracts, (4) federal appropriations, and (5) sales and services of educational activities.
- **Nonoperating revenues**—Nonoperating revenues include activities that have the characteristics of non-exchange transactions, such as gifts and contributions, and other revenues that are defined as nonoperating revenues by GASB No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting* and GASB No. 34, such as State appropriations and investment income. Nonoperating revenues also exclude student fees which were billed for capital improvements.

Use of Restricted Net Assets—WVSOM has not adopted a formal policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available. Generally, WVSOM attempts to utilize restricted net assets first when practicable.

Scholarship Allowances—Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship allowances in the statement of revenues, expenses and changes in net assets. Scholarship allowances are the difference between the stated charge for goods and services provided by WVSOM, and the amount that is paid by students and/or third parties making payments on the student's behalf.

Financial aid to students is reported in the financial statements under the alternative method as prescribed by the National Association of College and University Business Officers (NACUBO). Certain aid such as loans, funds provided to students as awarded by third parties, and Federal Direct Lending is accounted for as a third party payment (credited to the student's account as if the student made the payment). All other aid is reflected in the financial statements as operating expenses, or scholarship allowances, which reduce revenues. The amount reported as operating expense represents the portion of aid that was provided to the student in the form of cash. Scholarship allowances represent the portion of aid provided to the student in the form of reduced tuition. Under the alternative method, these amounts are computed on a school basis by allocating the cash payments to students, excluding payments for services, on the ratio of total aid to the aid not considered to be third party aid.

Government Grants and Contracts—Government grants and contracts normally provide for the recovery of direct and indirect costs, subject to audit. WVSOM recognizes revenue associated with direct costs as the related costs are incurred. Recovery of related indirect costs is generally recorded at fixed rates negotiated for a period of one to three years.

Income Taxes—WVSOM is exempt from income taxes, except for unrelated business income, as a nonprofit organization under federal income tax laws and regulations of the Internal Revenue Service.

Cash Flows—Any cash and cash equivalents escrowed, restricted for noncurrent assets or in funded reserves have not been included as cash and cash equivalents for the purpose of the statement of cash flows.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recent Statements Issued by the Government Accounting Standards Board—The GASB issued Statement No. 39, *Determining Whether Certain Organizations are Component Units*, an amendment of GASB Statement No. 14. This statement is effective for periods beginning after June 15, 2003. WVSOM has not completed the process of evaluating the impact, if any, that will result from adopting GASB Statement No. 39. This statement, when adopted, could result in additional entities being included in WVSOM’s financial statements.

3. CASH AND CASH EQUIVALENTS

The composition of cash and cash equivalents was as follows at June 30, 2002:

	Current	Noncurrent	Total
Cash on deposit with the State Treasurer	\$ 7,132,511	\$ 46,000	\$ 7,178,511
Cash in bank	1,345,569		1,345,569
Cash on hand	<u>4,918</u>	<u> </u>	<u>4,918</u>
	<u>\$ 8,482,998</u>	<u>\$ 46,000</u>	<u>\$ 8,528,998</u>

Cash held by the State Treasurer includes \$4,740,809 of restricted cash for grants, gifts, loans and plant.

The combined carrying amount of cash in bank at June 30, 2002 was \$1,345,569, as compared with the combined bank balance of \$1,304,673. The difference is primarily caused by outstanding checks and items in transit. The bank balances at June 30, 2002 were covered by federal depository insurance or were collateralized by securities held by the State’s agent.

Cash on deposit with the State Treasurer is a noncategorized deposit (with respect to risk and collateral disclosure) in accordance with GASB Statement No. 3, *Deposits with Financial Institutions, Investments (Including Receivable Agreements), and Reverse Repurchase Agreements*.

4. ACCOUNTS RECEIVABLE

Accounts receivable were as follows at June 30, 2002:

Student tuition and fees - no allowance deemed necessary	\$ 264,242
Grants and contracts receivable	33,860
Due from the Commission	122,502
Due from other State agencies	304
Other accounts receivable	<u>15,667</u>
	<u>\$ 436,575</u>

5. CAPITAL ASSETS

The following is a summary of capital asset transactions of WVSOM for the year ended June 30, 2002:

	Beginning Balance	Additions	Reductions	Other	Ending Balance
Capital assets not being depreciated:					
Land	\$ 473,050	\$ -	\$ -	\$ -	\$ 473,050
Construction in progress	<u>421,008</u>	<u>293,293</u>	<u>(421,008)</u>	<u>-</u>	<u>293,293</u>
Total capital assets not being depreciated	<u>\$ 894,058</u>	<u>\$ 293,293</u>	<u>\$ (421,008)</u>	<u>\$ -</u>	<u>\$ 766,343</u>
Other capital assets:					
Land improvements	\$ -	\$ 333,045	\$ -	\$ -	\$ 333,045
Buildings	15,044,781	983,460			16,028,241
Equipment	4,136,435	330,701	(249,089)		4,218,047
Library books	<u>187,497</u>	<u>57,555</u>	<u>(19,500)</u>	<u>-</u>	<u>225,552</u>
Total other capital assets	<u>19,368,713</u>	<u>1,704,761</u>	<u>(268,589)</u>	<u>-</u>	<u>20,804,885</u>
Less accumulated depreciation for:					
Land improvements		(12,716)			(12,716)
Buildings	(2,906,818)	(312,927)			(3,219,745)
Equipment	(2,675,688)	(274,877)	249,089		(2,701,476)
Library books	<u>(62,242)</u>	<u>(29,473)</u>	<u>19,500</u>	<u>-</u>	<u>(72,215)</u>
Total accumulated depreciation	<u>(5,644,748)</u>	<u>(629,993)</u>	<u>268,589</u>	<u>-</u>	<u>(6,006,152)</u>
Other capital assets, net	<u>\$ 13,723,965</u>	<u>\$ 1,074,768</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 14,798,733</u>
Capital asset summary:					
Capital assets not being depreciated	\$ 894,058	\$ 293,293	\$ (421,008)	\$ -	\$ 766,343
Other capital assets	<u>19,368,713</u>	<u>1,704,761</u>	<u>(268,589)</u>	<u>-</u>	<u>20,804,885</u>
Total cost of capital assets	20,262,771	1,998,054	(689,597)		21,571,228
Less accumulated depreciation	<u>(5,644,748)</u>	<u>(629,993)</u>	<u>268,589</u>	<u>-</u>	<u>(6,006,152)</u>
Capital assets, net	<u>\$ 14,618,023</u>	<u>\$ 1,368,061</u>	<u>\$ (421,008)</u>	<u>\$ -</u>	<u>\$ 15,565,076</u>

WVSOM has approximately \$900,000 of construction commitments at June 30, 2002.

WVSOM maintains various collections of inexhaustible assets to which no value can be practicably determined. Such collections include contributed works of art, historical treasures and literature that are held for exhibition, education, research and public service. These collections are neither disposed of for financial gain nor encumbered in any means. Accordingly, such collections are not capitalized or recognized for financial statement purposes.

Title for certain real property is with the Commission.

6. CHANGES IN LONG-TERM LIABILITIES

The following is a summary of long-term obligation transactions of WVSOM for the year ended June 30, 2002:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Long-term liabilities:					
Accrued compensated absences	\$ 1,232,056	\$ 113,686	\$ -	\$ 1,345,742	\$ 438,141
Advances from federal sponsors	<u>1,988,066</u>	<u>28,767</u>	<u> </u>	<u>2,016,833</u>	<u> </u>
Total long-term liabilities	<u>\$ 3,220,122</u>	<u>\$ 142,453</u>	<u>\$ -</u>	<u>\$ 3,362,575</u>	<u>\$ 438,141</u>

7. COMPENSATED ABSENCES

The composition of the compensated absence liability at June 30, 2002 was as follows:

Accrued health or life insurance benefits	\$ 706,850
Accrued vacation leave	<u>638,892</u>
	<u>\$ 1,345,742</u>

The cost of health and life insurance benefits paid by WVSOM is based on a combination of years of service and age. For the year ended June 30, 2002, the amount paid by WVSOM for extended health or life insurance coverage retirement benefits totaled approximately \$9,502. As of June 30, 2002, there were eight retirees currently eligible for these benefits.

8. LEASES

WVSOM leases various equipment under agreements reported as operating leases. As of June 30, 2002, the future annual minimum lease payments are as follows:

2003	\$ 64,460
2004	49,036
2005	<u>13,713</u>
	<u>\$ 127,209</u>

The total rent expense for this equipment for the year ended June 30, 2002 was \$75,044.

9. STATE SYSTEM OF HIGHER EDUCATION INDEBTEDNESS

WVSOM receives a State appropriation to finance a portion of its operations. In addition, it is subject to the legislative and administrative mandates of State government. Those mandates affect all aspects of WVSOM's operations, its tuition and fee structure, its personnel policies and its administrative practices.

The State has chartered the Commission with the responsibility to construct or renovate, finance and maintain various academic and other facilities of the State's colleges and universities, including certain facilities of WVSOM. Financing for these facilities was provided through revenue bonds issued by the former Board of Regents or the former Boards of the State College System of West Virginia and the University System of West Virginia (the "Boards"). These obligations administered by the Commission are the direct and total responsibility of the Commission, as successor to the former Boards.

The Commission has the authority to assess each public institution of higher education for payment of debt service on these system bonds. The tuition and registration fees of the members of the former State University System ("System") are generally pledged as collateral for the Commission's bond indebtedness. Student fees collected by the institution in excess of the debt service allocation are retained by the institution for internal funding of capital projects and maintenance. Although the bonds remain as capital obligation of the Commission, an estimate of the obligation of each institution is reported as a long-term payable by each institution and as a receivable by the Commission, effective as of June 30, 2001. No amount of the System debt has been assessed by the Commission to WVSOM as of June 30, 2002.

10. RETIREMENT PLANS

Substantially all full-time employees of WVSOM participate in either the West Virginia Teachers' Retirement System (the "STRS") or the Teachers' Insurance and Annuities Association - College Retirement Equities Fund (the "TIAA-CREF"). Previously, upon full-time employment, all employees were required to make an irrevocable selection between the STRS and TIAA-CREF. Effective July 1, 1991, the STRS was closed to new participants. Current participants in the STRS are permitted to make a one-time election to cease their participation in that plan and commence contributions to the West Virginia Teachers' Defined Contribution Plan. Contributions to and participation in the West Virginia Teachers' Defined Contribution Plan by WVSOM employees have not been significant to date.

The STRS is a cost sharing, defined benefit public employee retirement system. Employer and employee contribution rates are established annually by the State Legislature. WVSOM accrued and paid its contribution to the STRS at the rate of 15% of each enrolled employee's total annual salary for the year ended June 30, 2002. Required employee contributions were at the rate of 6% of total annual salary for the year ended June 30, 2002. Participants in the STRS may retire with full benefits upon reaching age 60 with five years of service, age 55 with 30 years of service, or any age with 35 years of service. Lump-sum withdrawal of employee contributions is available upon termination of employment. Annual pension benefits are based upon 2% of final average salary (the highest five years salary out of the last 15 years) multiplied by the number of years of service.

The TIAA-CREF is a defined contribution plan in which benefits are based solely upon amounts contributed plus investment earnings. Employees who elect to participate in this plan are required to make a contribution equal to 6% of total annual compensation. WVSOM matches the employees' 6% contribution. Contributions are immediately and fully vested.

Total contributions to the STRS for the year ended June 30, 2002 were \$59,893, which consisted of \$42,781 from WVSOM and \$17,112 from the covered employees. Total contributions to STRS for the year ended June 30, 2001 were \$56,540, which consisted of \$40,386 from WVSOM and \$16,154 from covered employees. Total contributions to STRS for the year ended June 30, 2000 were \$51,450, which consisted of \$36,750 from WVSOM and \$14,700 from covered employees.

The contribution rate is set by the State Legislature on an overall basis, and the STRS does not perform a calculation of the contribution requirement for individual employers, such as WVSOM. Historical trend and net pension obligation information is available from the annual financial report of the Consolidated Public Retirement Board, Building 5, Room 1000, Charleston, West Virginia 25305.

Total contributions to the TIAA-CREF for the years ended June 30, 2002, 2001 and 2000 were \$773,300, \$753,761, and \$709,380, respectively, which consisted of equal contributions from WVSOM and covered employees of \$386,650, \$376,880, and \$354,690 in 2002, 2001 and 2000, respectively.

WVSOM's total benefits-eligible payroll for the year ended June 30, 2002 was \$6,758,909; total covered employees' salaries in the STRS and TIAA-CREF were \$285,210 and \$6,473,699, respectively.

11. FOUNDATION (UNAUDITED)

The West Virginia School of Osteopathic Medicine Foundation, Incorporated (the "Foundation") is a separate nonprofit organization incorporated in the State of West Virginia. Oversight of the Foundation is the responsibility of an independently elected Board of Directors, not otherwise affiliated with WVSOM. In carrying out its responsibilities, the Board of Directors of the Foundation employs management, forms policy and maintains fiscal accountability over funds administered by the Foundation. Accordingly, the financial statements of the Foundation are not included in the accompanying financial statements.

The Foundation's restricted and unrestricted fund balances totaled \$1,110,340 at June 30, 2002. The restricted fund balance includes amounts which are restricted by donors to use for specific projects or departments of WVSOM and its affiliated organizations. The restricted and unrestricted fund balances related to the endowments totaled \$182,110 for the year ended June 30, 2002. Foundation gifts, grants, pledges and bequests totaled \$400,325 for the year ended June 30, 2002. The separate financial statements of the Foundation may be obtained by writing to 400 North Lee Street, Lewisburg, WV 24901.

12. AFFILIATED ORGANIZATIONS (UNAUDITED)

The West Virginia School of Osteopathic Medicine Robert C. Byrd Clinic, Inc. (the "Clinic") operates a health center located in Lewisburg, West Virginia. The Clinic, opened in January of 1997, was established to provide health care to the community and to serve as a laboratory for the students of WVSOM. Although the Clinic was created for the purpose of assisting WVSOM in achieving its missions, it is a separate nonprofit organization incorporated in the State of West Virginia. Oversight of the Clinic is the responsibility of an independently elected Board of Directors, not otherwise affiliated with WVSOM. The Board of Directors employs management, forms policy and maintains fiscal accountability over the financial affairs of the Clinic. Accordingly, the financial statements of the Clinic are not included in the accompanying financial statements.

WVSOM owns the building in which the Clinic is operated and the cost of the building is recognized in WVSOM's financial statements. WVSOM has an operating lease with the clinic in which it charges the Clinic \$1 each month for rental of the office space and certain furniture and equipment.

In addition, WVSOM and the Clinic have agreements whereby WVSOM pays the Clinic for medical education services for students of WVSOM, certain office expenses and equipment rentals, and health services for students enrolled at WVSOM. For the year ended June 30, 2002, the amount paid by WVSOM for instruction, office expenses and equipment rental totaled \$200,000. WVSOM made payments totaling \$25,000 for the year ended June 30, 2002 to the Clinic for providing health services to WVSOM students. The financial statements of the Clinic are not publicly available.

The Mountain State Osteopathic Postdoctoral Training Institutions System, Inc. ("MSOPTI") is a consortium formed in 1998 through affiliation agreements between WVSOM and partner hospitals in the States of West Virginia and Ohio which provides post graduate clinical training to osteopathic interns and residents. The affiliation agreements with MSOPTI are renewed annually through contracts executed between each hospital, WVSOM and MSOPTI.

Although MSOPTI is a consortium created for the purpose of assisting WVSOM in achieving its mission, it is a separate non-profit organization incorporated in the State of West Virginia. Oversight of MSOPTI is the responsibility of a Board of Directors, as specified in the MSOPTI bylaws which is made up of three members from WVSOM and one member from each of the seven partner hospitals. In carrying out its responsibilities, the Board of Directors of MSOPTI employs management, forms policy and maintains fiscal accountability over funds administered by MSOPTI. Accordingly, the financial statements of MSOPTI are not included in the accompanying financial statements. For the year ended June 30, 2002, WVSOM contributed \$50,000 to MSOPTI. In addition, WVSOM incurred \$104,809 of personnel costs on MSOPTI's behalf and was reimbursed for these costs in the year ended June 30, 2002. The separate financial statements of MSOPTI are not publicly available.

13. CONTINGENCIES

The nature of the educational industry is such that, from time to time, claims will be presented against educational institutions on account of alleged negligence, acts of discrimination, breach of contract or disagreements arising from the interpretation of laws or regulations. While some of these claims may be for substantial amounts, they are not unusual in the ordinary course of providing educational services in a higher education system. In the opinion of management, all known claims are covered by insurance or are such that an award against WVSOM would not impact seriously on the financial status of the institution.

Under the terms of federal grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures under the terms of the grants. Such audits could lead to reimbursement to the grantor agencies. WVSOM's management believes that disallowances, if any, will not have a significant financial impact on WVSOM's financial position.

WVSOM owns various buildings which are known to contain asbestos. WVSOM is not required by federal, state or local law to remove the asbestos from its buildings. WVSOM is required under federal environmental, health and safety regulations to manage the presence of asbestos in its buildings in a safe condition. WVSOM addresses its responsibility to manage the presence of asbestos in its buildings on a case by case basis. Significant problems of dangerous asbestos conditions are abated as the conditions become known. WVSOM also addresses the presence of asbestos as building renovation or demolition projects are undertaken and through asbestos operation and maintenance programs directed at containing, managing or operating with the asbestos in a safe condition.

14. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The following table represents operating expenses for the year ended June 30, 2002 within both natural and functional classifications:

	Salaries and Wages	Benefits	Supplies and Other Services	Utilities	Scholarships and Fellowships	Depreciation	Loan Cancellations and Write-offs	Fees Assessed by the Commission	Total
Instruction	\$ 3,476,330	\$ 770,736	\$ 1,152,404	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 5,399,470
Research	109,803	24,411	47,581						181,795
Public service	91,030	21,350	986,644						1,099,024
Academic support	496,558	113,370	355,783					25,820	991,531
Student services	527,136	117,245	246,098						890,479
General institutional support	1,583,190	493,090	508,326						2,584,606
Operations and maintenance of plant	579,736	169,128	228,311	376,107					1,353,282
Student financial aid					6,000				6,000
Auxiliary enterprises	61,052	20,598	383,623						465,273
Depreciation						629,993			629,993
Other							48,346	184,293	232,639
Total	<u>\$ 6,924,835</u>	<u>\$ 1,729,928</u>	<u>\$ 3,908,770</u>	<u>\$ 376,107</u>	<u>\$ 6,000</u>	<u>\$ 629,993</u>	<u>\$ 48,346</u>	<u>\$ 210,113</u>	<u>\$ 13,834,092</u>

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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the West Virginia School of
Osteopathic Medicine Governing Board

We have audited the financial statements of West Virginia School of Osteopathic Medicine (“WVSOM”) as of and for the year ended June 30, 2002, and have issued our report thereon dated October 11, 2002, which contains a consistency exception for the adoption of Governmental Accounting Standards Board Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities*. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether WVSOM’s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered WVSOM’s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information of the WVSOM Governing Board and managements of WVSOM, West Virginia Higher Education Policy Commission, federal awarding agencies, State funding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

October 11, 2002